

STANDARD PROCEDURE		PAGE: 1 OF 3	
ISSUED BY: LEGAL			
EFFECTIVE DATE: 11/14/95, Revised 9/8/97			
PROCEDURE # 4.1			
SUBJECT: ANNUAL ADJUSTMENT OF TAX INTEREST RATE			
DISTRIBUTION CODE: A,B,C		CONTACT: Director- Tax Policy	
		Station:	#8
		Phone:	4-6843

I. POLICY

KRS 131.183(1) provides, in part, that "The Secretary of Revenue shall adjust the tax interest rate not later than November 15 of any year . . . if the adjusted prime rate charged by banks during October of that year, rounded to the nearest full percent, is at least one (1) percentage point more or less than the tax interest rate which is then in effect." In compliance with this provision, the Division of Tax Policy will conduct an annual survey of selected banks in Kentucky which charge a prime rate to their preferred customers and advise the Secretary of Revenue of the findings.

The prime rate represents the base upon which banks establish interest rates. Loans that are below the prime rate are generally those that are secured by sound collateral which present little or no risk such as real estate, both commercial and residential. Working capital loans made to large corporate customers commonly receive rates at prime or percentage points above the prime, based on nationally published prime rates such as *The Wall Street Journal* prime.

II. PROCEDURE

A. Definitions

The term "tax interest rate" is defined in KRS 131.010(6) as the interest rate determined under KRS 131.183 and, more specifically, subsection (1).

The term "adjusted prime rate charged by banks" is defined in KRS 131.010(5) as the average predominant prime rate quoted by commercial banks to large businesses, as determined by the Board of Governors of the Federal Reserve System.

The term "average predominant prime rate" as used in KRS 131.010(5) is interpreted to mean the average of the most prevailing rate that a bank charges to its most credit-worthy customers, generally corporations. It further is interpreted to mean the "average" of the averages such as the list provided in B. that follows.

The term "commercial banks" as used in KRS 131.010(5) is interpreted to mean a federally insured bank, chartered by either the Comptroller of the Currency or the state banking authority.

The term "large businesses" as used in KRS 131.010(5) is interpreted to mean the largest (in terms of asset size) corporate customers that the bank would extend loans to.

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B. Process

The Division of Tax Policy conducts a survey of nine banks located across the state during the first 5 days of each November. The banks currently being surveyed are located in Louisville (3), Lexington (2), Covington (2), Paducah (1) and Pikeville (1).

The "average predominant prime rate" charged by each bank during the previous month of October to its most credit-worthy customers, generally corporations, is recorded and totaled. If a bank has charged two different prime rates during October, the rate is calculated from weighted averages based on the number of days charged at each rate. An average rate charged by the banks is obtained by dividing the total by 9. The average is rounded to the nearest percent. If this rate is at least one percentage point above or below the current tax interest rate, the tax interest rate charged by the Cabinet for the following calendar year must be adjusted to reflect the new rate. The interest rate applicable to refunds must also reflect the new rate.

A memorandum is forwarded to the Secretary of Revenue from the Commissioner of the Department of Law explaining the process of obtaining the information of which to base the tax interest rate, including the name of the banks and the prime rate charged by each bank. An attachment to the memorandum reflects the telephone number of each bank, the prime rate charged by each bank and the contact person.

C. Review

The Director of Tax Policy must approve the draft of the memorandum to the Secretary prior to submitting it to the Commissioner of the Department of Law. Upon review and approval of the Commissioner, the memorandum is forwarded to the Secretary for approval.

D. Approval

After approval by the Secretary, a memorandum is sent from the Secretary to the Commissioner of the Department of Law indicating approval of the tax interest rate for the new calendar year.

E. Distribution and Publication

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. COUNSEL	
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Upon approval by the Secretary, the Commissioner of the Department of Law advises all other commissioners, the Taxpayer Ombudsman and all divisions and interested parties of the tax interest rate for the following calendar year. The Division of Tax Policy prepares this memorandum for the Commissioner of the Department of Law. A press release and an article for the "Tax Alert" are prepared by the Public Information and Communication Services Branch.

NO STANDARD PROCEDURE MAY BE REVISED BY ADDENDUM, MEMORANDUM OR ANY OTHER MEANS OTHER THAN THOSE SET OUT IN STANDARD PROCEDURE # 1.1 ENTITLED " CREATION, REVISION AND RESCISSION OF KRC POLICIES AND PROCEDURES"

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A. Senior Management	B. Division Directors	C. Branch Managers\Supervisors
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